



SF 124 – Military Income Tax Exemption (LSB1159XS)

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Fiscal Note Version – New

Description

Under current law, pay received from the federal government for military service performed by members of the armed forces, armed forces military reserve, and the National Guard in an active duty status as defined in [Title 10](#) of the U.S. Code is exempt from the Iowa individual income tax. [Senate File 124](#) eliminates the requirement that in order to qualify for the exemption, pay must be received for service while on active duty status. The change expands the current exclusion to include pay received for military service by members of the National Guard while on full-time National Guard duty under [Title 32](#) of the U.S. Code.

In addition, the Bill exempts service-related military disability compensation and benefits from Iowa individual income tax.

The Bill is retroactive to January 1, 2017, for tax years beginning on or after that date.

Assumptions

- Military service pay received by members of the armed forces and armed forces military reserve is exempt from the Iowa individual income tax under current law. Pay received by members of the National Guard is not exempt under current law except when the service is performed during active duty status as defined in Title 10 of the U.S. Code.
- Military service pay received by members of the National Guard while on full-time National Guard duty under Title 32 of the U.S. Code is not exempt from the Iowa individual income tax. According to information provided by staff of the Iowa National Guard, total pay received by personnel for such military service was \$206.2 million in the 2016 federal fiscal year. It is assumed that this number is also applicable to tax year 2016. The figure represents pay received for services performed while on full-time duty by members of the Iowa Air National Guard and Iowa Army National Guard, including active guard reserves, active duty operational staff, and technicians. For this estimate, it is assumed that the number of personnel receiving this pay will remain steady through 2022.
- Based on analysis of 2017 military pay schedules, it is assumed that the adjusted gross income (AGI) of members of the National Guard in Iowa in that year will be between \$30,000 and \$125,000. Iowa Department of Revenue (IDR) data for resident taxpayers indicates that, on average for taxpayers in this income group, taxable income represents 84.0% of AGI and tax liability represents 4.9% of taxable income.
- The Employment Cost Index (ECI) is the basis for annual changes in military pay schedules. It is assumed that increases in the ECI for subsequent years will be consistent with Moody's Analytics' Consensus Scenario Forecasts.
- According to information provided by staff of the U.S. Department of Veterans Affairs (VA), total compensation and benefits to veterans and survivors living in Iowa for a service-connected disability certified by the VA amounted to \$437.9 million in the 2016 federal fiscal year. It is assumed that this number is also applicable to tax year 2016. By federal law,

cost-of-living adjustments to VA compensation benefits are based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). It is assumed that increases in this index through 2022 will be consistent with Moody's Analytics' Consensus Scenario Forecasts.

- It is assumed that the AGI of taxpayers receiving VA disability compensation will typically be between \$10,000 and \$60,000 annually. Iowa Department of Revenue data for resident taxpayers indicates that, for taxpayers in this income group, taxable income ignoring deductions for federal tax represents 90.0% of AGI. Because VA disability compensation is not subject to the federal individual income tax, it is assumed that 90.0% of VA disability compensation to Iowa taxpayers will be taxable for the Iowa individual income tax in years 2017 through 2022. Based on analysis of data for taxpayers with similar levels of AGI, it is assumed that tax liability will represent 3.5% of taxable income of taxpayers receiving VA disability compensation during this period.
- The following table presents the estimated income tax reduction associated with each of the two tax exemptions.

Iowa Income Tax Reduction				
Dollars in Millions				
	Disability	Title 32		
	Compensation	National Guard		
		Duty Pay		Total
TY 2017	\$ -13.8	\$ -8.7	\$	-22.5
TY 2018	-14.2	-8.9		-23.1
TY 2019	-14.5	-9.1		-23.6
TY 2020	-14.8	-9.4		-24.2
TY 2021	-15.1	-9.6		-24.7
TY 2022	-15.4	-9.8		-25.2

Fiscal Impact

Expanding the current exemption for active duty military pay to include additional National Guard pay and exempting military disability payments from the Iowa income tax is projected to reduce net General Fund revenue by the amounts depicted on the right-hand side of the following table. Negative impacts beyond FY 2022 continue, with impacts increasing with the rate of increase in military pay and disability income received by Iowans.

Projected General Fund Impact

Dollars in Millions

<u>Income Tax Reduction</u>		<u>Fiscal Year Impacts</u>	
TY 2017	\$ -22.5	FY 2017	\$ 0.0
TY 2018	-23.1	FY 2018	-32.1
TY 2019	-23.6	FY 2019	-23.3
TY 2020	-24.2	FY 2020	-23.8
TY 2021	-24.7	FY 2021	-24.4
TY 2022	-25.2	FY 2022	-25.0

The exclusion also reduces the amount of revenue generated by the local option income surtax for schools. The reduction is estimated to be \$0.8 million each tax year, beginning TY 2017.

Sources

Iowa Department of Revenue

Iowa National Guard

Moody's Analytics' Consensus Scenario Forecasts

/s/ Holly M. Lyons

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The fiscal note for this bill was prepared pursuant to [Joint Rule 17](#) and the Iowa Code. Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.
